IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-564

HUNTINGTON TOWERS, LTD.
and RICHARD CAREY,

Petitioners,

v.

FRANKLIN NATIONAL BANK (in liquidation)
and FEDERAL DEPOSIT INSURANCE CORPORATION,

Defendants,

FEDERAL RESERVE BANK OF NEW YORK,
EUROPEAN-AMERICAN BANK, and JAMES SMITH,
individually and as Comptroller of the Currency,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT FEDERAL RESERVE BANK OF NEW YORK IN OPPOSITION

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Preliminary Statement

In May 1974, Franklin National Bank ("Franklin National"), then the nation's twentieth-largest bank with large foreign exchange commitments, was faced with a severe and well-publicized liquidity crisis. Without access to funds from the Federal Reserve System, the lender of last resort, a run on the bank which would have forced Franklin National to close its doors was inevitable. It

was entirely possible that the closing of Franklin National in these circumstances would have resulted in a bank panic of incalculable national and international dimensions.

The Comptroller of the Currency ("Comptroller"), whose satisfaction with a national bank's solvency or insolvency is by statute the principal determinant of whether a national bank is to be placed in receivership, determined that Franklin National was solvent although facing a massive liquidity crisis. The Comptroller so advised the Board of Governors of the Federal Reserve System ("Federal Reserve Board").

The Federal Reserve Bank of New York ("Reserve Bank") is authorized by statute to make advances to member banks precisely so as to avoid the consequences threatening Franklin National in particular and the banking system in general. The Reserve Bank is required by statute to obtain collateral satisfactory to it to secure such advances. In accordance with this statutory authority and requirement, the Reserve Bank made massive collateralized advances to Franklin National beginning in May 1974.

Ultimately, on October 8, 1974, the Comptroller became "satisfied" (the statutory term) that Franklin National was insolvent and appointed the Federal Deposit Insurance Corporation ("FDIC") as its receiver. The FDIC that day, with court approval as required by statute and with the release by the Reserve Bank of its lien, sold and transferred most of the assets and liabilities of Franklin National to European American Bank, which continued the banking business of Franklin National without interruption. In its corporate capacity the FDIC assumed primary responsibility for repayment of the advances, aggregating some $1.7 billion, which the Reserve Bank had made to Franklin National. The doors of Franklin

National (under the name of European American Bank) were open the following morning, and the consequences which the precipitous closing of Franklin National in May 1974 would have brought were avoided.

Insofar as it relates to the Reserve Bank, the petition seeks review of the decision of the court of appeals that (i) the district court lacked subject matter jurisdiction of petitioners' claim that the making by the Reserve Bank of the advances to Franklin National constituted a tort and (ii) the presence of the Reserve Bank in the action was not necessary in respect of petitioners' attempt to reclaim collateral they had pledged to Franklin National. Petitioners (together "Huntington") have not presented any sufficient ground for review by this Court or any pertinent authority in support of their position.

Reversal of the decision below, either on the ground that the making of such advances is a justiciable tort or that the Reserve Bank obtained a preference since the advances were collateralized—as the statute requires them to be—would effectively deprive Federal Reserve Banks of their statutory authority to deal with liquidity crises such as that of Franklin National. Such a revision of the statutory scheme for solving banks' liquidity problems is, we submit, for the Congress, not the courts.

Opinions Below

The Memorandum of Decision and Order dated July 1, 1976 of the United States District Court for the Eastern District of New York (Pet. p. A23-A51) has not been officially reported. The Decision and Order of the United States Court of Appeals for the Second Circuit dated July 19, 1977 affirming in part and reversing in part the decision of the District Court (Pet. p. A1-A22) is reported at 559 F.2d 863.

Questions Presented

The principal question which would be presented by a review of the decision of the court of appeals affirming the judgment dismissing the claims against the Reserve Bank is:

> Does the making pursuant to the Federal Reserve Act by a Federal Reserve Bank of collateralized advances to a national bank, which has not been declared by the Comptroller to be insolvent, give rise to a justiciable claim that the Federal Reserve Bank has committed a tort or received an unlawful preference?

Additional questions are presented:

> May the courts determine that the Comptroller "should" have determined a national bank to be insolvent at a date earlier than that when he became "satisfied" of its insolvency and thus that "insolvency" had occurred earlier?

> Is the receipt by a Federal Reserve Bank of collateral required for new monies advanced to a national bank an unlawful preference?

We submit that the answer to each of these questions is in the negative.

But there is no need for the Court to reach any of these questions since no basis for a grant of the writ has been made out by the petitioners. The supposed conflict within the Court of Appeals for the Second Circuit does not exist, since the other decision cited deals with issues of personal tort immunity of government officials, not the justiciability of a claim directed against action by a Federal Reserve Bank of the sort involved here. The contention that the decision below violates the principle of ratable distributions ignores the congressional requirement that Reserve Banks make advances only against collateral; there simply is no conflict between recognition of the position of a secured creditor and a requirement that unsecured creditors receive parity of treatment.

Counter-Statement of the Case

The Federal Banking System

The Federal Reserve System was created by Congress to prevent the monetary crises, periodic loss of public confidence in the banking system and runs on banks which had been a feature of the American economy in the nineteenth century and the early part of this century. The System consists of the Federal Reserve Board, whose members are appointed by the President with the advice and consent of the Senate, the twelve Federal Reserve Banks and the Federal Open Market Committee.*

The Federal Reserve Act requires that each national banking association be a member of the system and a stockholder of the Federal Reserve Bank in its Reserve District, 12 U.S.C. § 282 (1970).** One of the principal functions of a Federal Reserve Bank is to make loans to member banks, often on an immediate basis, in order to ensure the efficient functioning and stability of the monetary system, subject to regulations promulgated by the Federal Reserve Board, 12 U.S.C. §§ 301, 347, 347b, 347c

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*** The Federal Open Market Committee establishes monetary policy which is effectuated principally by purchase or sale of Treasury obligations.**

**** After providing a fixed return of 6% to the stockholders, virtually all of the net earnings of the Federal Reserve Banks are paid over to the Treasury; in 1976, 97.6%. *Sixty-Third Annual Report of the Board of Governors of the Federal Reserve System, 1976*, 461.**

(1970 & Supp. V 1975). The Federal Reserve Board has promulgated Regulation A, 12 C.F.R. §201, to regulate Federal Reserve Banks in carrying out this statutory authority. Such loans must be secured by United States Government securities, 12 U.S.C. § 347c (1970), or otherwise secured "to the satisfaction of" the Federal Reserve Bank, 12 U.S.C. § 347b (Supp. V 1975).

The Comptroller is an official of the Department of the Treasury subject to the general direction of the Secretary of the Treasury, 12 U.S.C. § 1 (1970). He is responsible for the chartering, examination and supervision of national banks, 12 U.S.C. §§ 26, 161 (1970). The statute further provides that he shall appoint a receiver of a national bank in three situations. Two are objective events of insolvency (dissolution upon suit by the Comptroller for charter forfeiture or failure to pay a judgment within 30 days, 12 U.S.C. § 191 (1970)), neither of which occurred here. The third is:

> ". . . whenever the Comptroller shall become satisfied of the insolvency of a national banking association, he may, after due examination of its affairs . . . appoint a receiver who shall proceed to close up such association." 12 U.S.C. § 191 (1970).

The FDIC acts in several capacities when a national bank is declared insolvent by the Comptroller. First—and this is its best known function—it pays depositors whose accounts it has insured, either directly or by making available a transferred deposit in another insured bank. Second, the statute provides that when the Comptroller appoints a receiver for a national bank, he shall appoint the FDIC, 12 U.S.C. § 1821(c), (f) (1970).

After the Comptroller is satisfied that a national bank is insolvent and appoints the FDIC as receiver, the FDIC

"upon the order of a court of record of competent jurisdiction . . . may sell all the real and personal property of such association on such terms as the court shall direct." 12 U.S.C. § 192 (1970).

The Authority of Federal Reserve Banks to Make Collateralized Advances to Member Banks

While a national banking system was first established during the Civil War, the Federal Reserve System dates from the reforms of 1913. Act of December 23, 1913, ch. 6, 38 Stat. 251. The report of the House Committee recommending passage of the bill which became the Federal Reserve Act, H.R. Rep. No. 69, 63rd Cong., 1st Sess. (1913), discussed the "longstanding evils" and "essential defects" in the national banking system which the bill was intended to correct, *Id.* at 3, including:

> (a) "[T]he country has lacked the capacity either to prevent credit disorders from breaking out locally and spreading to the centers, or to defend its own resources against the monetary demands of foreign nations or against the infection due to bad financial conditions in countries with which we stood in close relations." (*Id.* at 4)
>
> (b) "In 1873, 1884, 1890, 1893, 1896 and 1907, to mention the most familiar occasions, it has been necessary for large groups of banks practically to suspend specie payments. . . . In spite of all that could be done, however, the public has been put to great inconvenience and loss upon such occasions, the relations of the United States with foreign countries have been embarrassed, if not brought into jeopardy, the failure of firms, corporations, and individuals has been necessitated, and the loss of wealth has been tremendous." *(Id.)*

(c) "[T]he national banking system . . . fails to afford any safeguard against panics and commercial stringencies or any means of alleviating them." (H.R. Rep. No. 69 at 6)

To solve these problems, the report went on to specify the fundamental objects of the proposed legislation, which included:

"General economy of reserves in order that such reserves might be held ready for use in protecting the banks of any section of the country and for enabling them to go on meeting their obligations instead of suspending payments, as so often in the past." (*Id.* at 11)

Since then, further refinements in the system have been made, particularly in response to the crash of 1929 and its aftermath. We focus herein on the power of Federal Reserve Banks to make advances to member banks.

12 U.S.C. § *347*—The first limited grant of authority for advances by Federal Reserve Banks to member banks on the members' notes was given in Section 13 of the Federal Reserve Act amendments of 1916, Act of September 7, 1916, ch. 461, 39 Stat. 752.

This provision was substantially reformulated by Section 9 of the Banking Act of 1933. Act of June 16, 1933, ch. 89, § 9, 48 Stat. 180. *See* S. Rep. No. 77, 73d Cong., 1st Sess. 14 (1933); H.R. Rep. No. 150, 73d Cong., 1st Sess. 2 (1933). Apart from several amendments with respect to the types of collateral required as security for the notes of member banks, the provision exists today in substantially the same form in 12 U.S.C. § 347 (1970). It sets forth in technical detail the types of security which a member bank must pledge to secure advances from a Reserve

Bank pursuant to its provisions. (*E.g.,* Treasury bills, debentures of some Federal credit banks, notes eligible for rediscount).

12 U.S.C. § *347b*—In response to the banking emergency that followed the crash of 1929, Congress passed emergency legislation adding Section 10(b) to the Federal Reserve Act, which provided for additional temporary advances to member banks on a less restricted basis than Section 13. Act of February 27, 1932, ch. 58, §§ 1-2, 47 Stat. 56. This temporary authority was extended and expanded several times; for example, in 1933, the restriction on the size of member banks to which such advances could be made was eliminated (Act of March 9, 1933, ch. 1, § 402, 48 Stat. 7). Most of the remaining restrictions were eliminated when Congress finally made Section 10(b) a permanent provision of the Federal Reserve Act.

In 1935 Congress granted permanent authority for such advances and amended Section 10(b) of the Federal Reserve Act to read as follows:

"Any Federal Reserve bank, under rules and regulations prescribed by the Board of Governors of the Federal Reserve System, may make advances to any member bank on its time or demand notes having maturities of not more than four months and which are secured to the satisfaction of such Federal Reserve bank. Each such note shall bear interest at a rate not less than one-half of 1 per centum per annum higher than the highest discount rate in effect at such Federal Reserve Bank on the date of such note." Act of August 23, 1935, ch. 614, § 204, 49 Stat. 705.

The House report on § 206 of the original House bill, H.R. Rep. No. 742, 74th Cong., 1st Sess. (1935), discussed the reasons for the amendment of Section 10(b):

"Existing limitations had to be suspended during the emergency, but this was accomplished only after they had done a great deal of harm and after many banks had failed because of a lack of assets technically eligible for obtaining accommodation at a Federal Reserve bank. Since in practice existing restrictions must be relaxed whenever they become really restrictive, it is best not to have them in the law, but to place full regulatory responsibility on the Board, which is always in session and in a position to take prompt action when it is required.

• • •

"This amendment, by removing many of the technical restrictions of the present law, will enable the Federal Reserve banks to render better service to their member banks in times of need. This will not only make membership in the Federal Reserve System much more attractive but will encourage the member banks to invest their savings deposits, which are essentially capital funds, in longer-term loans, a course that would greatly facilitate business recovery.

"This amendment will also make it possible for banks, without relaxing prudence or care, to meet local needs both for short-time and for long-time funds, and to be assured that in case of need they can obtain advances from the Reserve banks on the basis of all their sound assets, regardless of their form or of the nature of their collateral." (at 10-11)

Pursuant to these provisions, and the power given the Federal Reserve Board to issue regulations by Section 4(8) of the Act, 12 U.S.C. § 301, the Board promulgated Regulation A which provided *inter alia:*

"(c) *Short-term adjustment credit.* Federal Reserve credit is available on a short-term basis to a member bank, under such rules as may be prescribed, to such extent as may be appropriate to assist such bank in meeting temporary requirements for funds or to cushion more persistent outflows of funds pending an orderly adjustment of the bank's assets and liabilities." 12 C.F.R. § 201.2(c) (1977)

• • •

"(e) *Emergency credit for member banks.* Federal Reserve credit is available to assist member banks in unusual or emergency circumstances such as may result from national, regional, or local difficulties or from exceptional circumstances involving only a particular member bank." 38 Fed. Reg. 9,076 (1973)*

* The amendment of subparagraph (e) of Regulation A by the Federal Reserve Board, effective September 25, 1974, further clarified the meaning of "exceptional circumstances" involving a particular bank:

"(e) *Other credit to member banks.* (1) In the event of unusual or emergency circumstances resulting from national, regional, or local difficulties, Federal Reserve credit beyond that contemplated under paragraph (c) of this section is available.

"(2) Federal Reserve credit is also available for protracted assistance where there are exceptional circumstances or practices involving only a particular member bank. A special rate apart from rates charged for lending to member banks under other provisions of this Part may be established by Federal Reserve Banks subject to review and determination by the Board of Governors and applied to such credit. The special rate may apply to member banks borrowing for prolonged periods (such as for more than eight weeks) and in significant amounts (such as when the loan has exceeded on average the amount of the borrowing bank's required reserves) because of financial strains arising from particular circumstances or practices affecting the individual bank—including sustained deposit drains, impaired access to money market funds, or sudden deterioration in loan repayment performance. In no case should the special loan rate to member banks exceed the rate established for loans to nonmembers under 12 U.S.C. 347(c)." 12 C.F.R. § 201.2(e) (1977)

The Franklin National Bank Crisis

By mid-May 1974, it was public knowledge that Franklin National had suffered large losses due to certain foreign exchange transactions and was in a precarious financial position. On Sunday, May 12, 1974, George W. Mitchell, Vice Chairman of the Federal Reserve Board, announced that the Federal Reserve System stood ready to advance funds to the Franklin National and that:

> "As a matter of general policy the Federal Reserve makes credit extensions to member banks, upon acceptable collateral, so long as the borrowing member bank is solvent. We are assured by the Comptroller of the Currency that Franklin National Bank is a solvent institution." (Pet. p. A41-42)*

A letter from the Acting Comptroller of the Currency to the Federal Reserve Board, dated May 10, 1974, stated:

> "At the last full examination of the subject bank which terminated on March 8, 1974, the bank was found to have fairly severe credit and liquidity problems, but was adjudged to be solvent. Although the liquidity problem has subsequently become aggravated by adverse rumors circulating in the market place, to date, we have not received any information which would materially alter our March 8, 1974 conclusion that the bank is solvent. If there is any significant change in the condition of the bank, this Office will promptly advise you." (Pet. p. A41)

That Franklin National faced severe liquidity problems which in the circumstances made it appropriate in the Reserve Bank's judgment for it to lend, on a collateralized basis as mandated by statute, massive amounts to Franklin National was hardly a secret. By May 31, 1974, it was public knowledge that Franklin National's borrowings from the Reserve Bank had risen to over one billion dollars.

* This announcement was preceded by disclosures during the week which on May 13, 1974 led the Securities and Exchange Commission to suspend trading in the stock of Franklin National's parent holding company. 39 Fed. Reg. 18,166 (1974)

Throughout the summer of 1974 there were various efforts, widely known, to find a solution to the liquidity problem of Franklin National and permit repayment of the Reserve Bank's loans whether by merger of Franklin National with another bank or otherwise.

By the fall, the search for a merger partner had failed, and the only viable alternative solution was a sale of Franklin National's assets to another bank which would also assume its deposit liabilities. On October 8, 1974, the Comptroller declared, pursuant to 12 U.S.C. § 191 (1970), that he had become satisfied that Franklin National was insolvent, and he appointed the FDIC as receiver for the Franklin National. The receiver issued a call for bids for the purchase of Franklin National's assets (pursuant to previously drafted documents) and determined that the bid by the European American was the best bid submitted.

Immediately thereafter, the district court, pursuant to 12 U.S.C. § 192 (1970), approved the receiver's sale of most of the assets, finding that it appeared to be the "best solution to a serious and delicate problem." *In re Franklin National Bank,* 381 F.Supp. 1390, at 1393 (E.D.N.Y. 1974). The following morning Franklin National's doors were open, but under the name of the new owner of its banking business.

The Complaint

Huntington's complaint, filed April 23, 1975, made two claims. The first was that the Comptroller's failure to declare Franklin National insolvent and the Reserve Bank's

massive assistance to it constituted a fraudulent representation as to the bank's condition, although the extent of the collateralized assistance and the troubled condition of the bank were publicly announced at the time. The second claim was that the Reserve Bank's required taking of collateral for the new monies it advanced to the Franklin National constituted a "preference". (Pet. p. A13)

The complaint alleged, on information and belief, that Franklin National was insolvent on or about May 1, 1974 and that on or about May 15, 1974 the defendants (including the Reserve Bank) knew the bank was insolvent and that it "should" have been declared insolvent. The defendants, so the claim alleged, entered into a "scheme" to conceal the purported insolvency and as part of the "scheme" the Reserve Bank made collateralized advances to Franklin National. (Pet. p. A5)

Huntington is a real estate developer which had borrowed construction funds from Franklin National and in June of 1974 allegedly gave additional security to Franklin National pursuant to its agreement with the bank. In September 1974, it was alleged, that due to Franklin National's financial condition, the bank was no longer able to advance further funds for the construction with the result that Huntington's construction came to a halt. Damages of $8,000,000 were claimed, without explanation. (Pet. p. A4-A5)

In the second claim, Huntington claimed to be "general creditors" of Franklin National, presumably on the theory that Franklin National allegedly owed Huntington $8,000,000 by reason of the first claim. Huntington alleged, again on information and belief, that the sale of assets and other arrangements approved by the district court pursuant to 12 U.S.C. § 192 (1970) "are contrary to law and constitute a fraud on the general creditors of Franklin

National." (Pet. p. A27) The complaint sought a declaration that the Reserve Bank "is not entitled to any security interest or preference" as against the plaintiffs and an injunction against the FDIC recognizing any such security interest. (Pet. p. A27)

The final item of the prayer for relief of the complaint demanded that the court declare null and void all mortgages and notes given to Franklin by Huntington, thus eliminating all evidence of and security for Huntington's debt to Franklin National.

The Decision of the District Court

The district court, *per* the late Orrin J. Judd, D.J., held that the Comptroller's determination that he was, in the express terms of 12 U.S.C. § 191, "satisfied" that Franklin National was solvent is unreviewable, and that his decision cannot be collaterally challenged by way of a claim against the Reserve Bank.

As to Huntington's assertion that the Reserve Bank "should" not have made advances to Franklin, the court held that such discretionary determinations are also not reviewable. The court found that if such decisions were to be subjected to scrutiny by courts after the fact, the ability of Federal Reserve Banks to react swiftly pursuant to their statutory authority to deal with bank liquidity crises would be unacceptably inhibited.*

* While the district court also based its dismissal of Huntington's "tort" claim on the Federal Tort Claims Act, 28 U.S.C. § 2680(h) (Supp. V 1975), there was no need to do so, since the discretionary action of the Reserve Bank involved here is not justiciable whether or not the jurisdictional limitations of the Federal Tort Claims Act apply to Federal Reserve Banks. The court of appeals affirmed the district court's dismissal of the complaint, but on the ground that subject matter jurisdiction was lacking.

Huntington's claim that the secured advances made by the Reserve Bank constituted a "preference" was also found to be without merit, since 12 U.S.C. § 347b specifically authorizes such loans and requires that they be collateralized. The court found that an essential purpose of the Federal Reserve Act was to give Federal Reserve Banks the authority to act as lenders of last resort to member banks and to respond to problems affecting the banking system as a whole. The court also relied on the principle that a pledge of collateral for new money (as opposed to an antecedent debt) is not a preference. Finally, the court found that, in any case, the Reserve Bank was not needed as a party to the action since its lien had been released for the benefit of European American Bank and the FDIC.

The Decision of the Court of Appeals

As did the district court, the court of appeals recognized that the actions of the Reserve Bank attacked by Huntington served to minimize the effects of a liquidity crisis and a resulting premature insolvency and the incalculable effects on the banking system and the national economy. The court held that subject matter jurisdiction was lacking for Huntington's claim of tort and affirmed the district court's decision that both the fixing of the date of insolvency by the Comptroller and the making of collateralized advances by the Reserve Bank were exercises of judgment within their competence and authority. Referring to the regulations concerning advances and the legislative history, the court of appeals held that the Reserve Bank, in making the advances, was doing precisely what Congress intended it to do in such situations. The court held that, absent clear evidence of grossly arbitrary or capricious action on the part of the Comptroller or the

Reserve Bank, an attack upon their performance of functions essential to the stability of the nation's banking system is not justiciable.

As to Huntington's second claim that the Reserve Bank, in taking collateral as security for the advances it made (as required by 12 U.S.C. § 347(b)), received a "preference", the court found that the Reserve Bank was not a necessary party to the claim because it had released its lien on the collateral and that if Huntington's claims were meritorious, the proper party affected would be the FDIC, not the Reserve Bank. The court ruled that Huntington Towers could continue its claim for "rescission" against FDIC, as receiver, and if it established a right to excess collateral over the debt pledged, it could assert its claim for legal or equitable relief against European American Bank as assignee, but until then such a claim would be premature.

REASONS FOR DENYING THE WRIT

I.

No Sufficient Ground for the Grant of a Writ of Certiorari Has Been Stated.

Both of the asserted grounds for granting the writ are based on non-existent conflicts.

—Huntington claims that the decision below conflicts with *Economou* v. *United States Department of Agriculture,* 535 F.2d 688 (2d Cir. 1976), *cert. granted sub nom. Butz* v. *Economou,* 429 U.S. 1089 (1977). *Economou* dealt only with the extent (absolute or qualified) of immunity of federal officials from personal liability for damage suits based on their partic-

ipation in the institution or prosecution of administrative enforcement proceedings. The court below stated that it perceived no conflict between that decision and its decision here, and there is none. (Pet. p. A15 n.2)

—Huntington also asserts that the decision below conflicts with the congressional policy in favor of ratable distributions. There is no conflict between the recognition of the superior rights of lien holders and the requirement that what remains after such recognition be distributed ratably.

II.

The Courts Below Correctly Decided That the Making of Collateralized Advances by a Federal Reserve Bank Does Not Present a Justiciable Claim.

The court of appeals found that in making collateralized advances to Franklin National, which had not been determined to be insolvent by the Comptroller, the Reserve Bank was discharging a judgmental governmental function for the precise purpose that the function was intended—to meet liquidity crises involving national banks—and that the propriety of the making of these advances was not subject to later attack in an action such as this.*

The pertinent statutes and regulations fully support that decision. Sections 10 and 13 of the Federal Reserve Act, 12 U.S.C. § 347b (Supp. V 1975) and 12 U.S.C. § 347 (1970) and Regulation A precisely authorized Federal Reserve Banks to make collateralized advances to national banks in accordance with their best judgment regarding the pres-

* The cases cited by the court of appeals and discussed herein as well as the legislative history of the national banking acts demonstrate that such decisions are governmental functions. *See Federal Reserve Bank* v. *Commissioner of Corporations and Taxation*, 499 F.2d 60, 62-64 (1st Cir. 1974).

ence or absence of emergency or exceptional circumstances and the acceptability of the available collateral. The issue therefore, if properly presented, is not whether the "bank regulators" are "absolutely immune", as Huntington would frame it, but whether a statutory scheme, couched, as it necessarily is, in permissive terms that advances "may" be made and that the Comptroller acts when he is "satisfied" as to insolvency, provides a private cause of action or permits judicial review of decisions made pursuant to the pertinent legislation.*

Many factors are involved in the decision to advance money to a troubled national bank and they can only be evaluated by officers of Federal Reserve Banks in light of their expertise acquired through experience in this specialized area of banking and their intimate knowledge of the state of the economy and the national bank in question. The decision, as was true in the case of Franklin National, must often be made immediately if the bank's doors are to remain open and panic is to be avoided.

It would invite financial chaos for the courts to intrude after the fact upon the determination of the Comptroller of whether or not a national bank is insolvent or the deci-

* The only basis alleged in the complaint for Huntington's "fraud" claim was the Comptroller's failure to declare the Franklin National insolvent in May, 1974 and the advances made by the Reserve Bank when it "knew" the bank "should" have been declared insolvent. Nothing which might permit an inference of some independent fraud was asserted. As the court found in *Davis* v. *Federal Deposit Insurance Corp.*, 369 F. Supp. 277, 280 (D. Colo. 1974) the respondents were under no duty to disclose to the plaintiff what they "knew" about the financial condition of the bank and indeed what was publicly known. This distinguishes the sole case relied upon by Huntington as authority that it had stated a cause of action for fraud. *Cassidy* v. *Uhlmann*, 27 App. Div. 80, 50 N.Y.S. 318 (1st Dep't 1898), *rev'd on other grounds,* 163 N.Y. 380, 57 N.E. 620 (1900) (Pet. p. 21) involved the fiduciary duty of bank directors to disclose to depositors their knowledge of the insolvency of the bank.

sion of a Federal Reserve Bank to advance funds to solve a liquidity crisis and thus to keep a national bank from closing its doors prior to a determination of insolvency by the Comptroller. The existence and viability of financial institutions depend, in a most crucial manner, upon continued public confidence. When the public loses confidence in a bank, depositors will cause a run on the bank, preventing it from honoring checks drawn on its accounts, and thus threatening public confidence in other banks. The federal regulatory scheme is designed to reduce the risk of such public panics—the Federal Reserve Banks act as lenders of last resort to assist banks with problems of maintaining liquidity, the FDIC insures deposits and the Comptroller decides when a bank has reached the point where there is no alternative but a receiver. This complex mechanism cannot function if the decisions of the banking authorities to act or not to act are subject to later attack in private litigation, and in particular, if the courts undertake to decide whether and when the Comptroller should be "satisfied" that a national bank is insolvent, or whether or when a Reserve Bank may lend funds to a troubled national bank.

This was one of the points of this Court's decision in *Securities Investor Protection Corp.* v. *Barbour,* 421 U.S. 412 (1975), *per* Mr. Justice Marshall, which held that the customers of a brokerage firm could not sue to compel the Securities Investor Protection Corporation ("SIPC") to grant its protection to the brokerage firm. The Court noted the special expertise and range of alternatives employed by SIPC, which generally delays seeking a receiver until there are no realistic alternatives.

> "By this policy, the SIPC avoids unnecessarily engendering the costs of precipitate liquidations—the costs not only of administering the liquidation, but also of

> customer illiquidity and additional loss of confidence in the capital markets—without sacrifice of any customer protection that may ultimately prove necessary. A customer, by contrast, cannot be expected to consider, or have adequate information to consider, these public interests in timing his decision to apply to the courts.
>
> "The respondent in this case does not, of course, claim any right to make the decision that a firm should be liquidated; the Act makes that a judicial decision. He seeks only the right to ask the District Court to make that decision when both SIPC and the SEC have refused or simply failed to do so. In practical effect, however, the difference is slight. Except with respect to the solidest of houses, the mere filing of an action predicated upon allegations of financial insecurity might often prove fatal. Other customers could not be expected to leave their cash and securities on deposit, nor other brokers to initiate new transactions that the firm might not be able to cover when due if a receiver is appointed, nor would suppliers be likely to continue dealing with such a firm. These consequences are too grave, and when unnecessary, too inimical to the purposes of the Act, for the Court to impute to Congress an intent to grant to every member of the investing public control over their occurrence. On the contrary, they seem to be the very sorts of considerations that motivated Congress to put SIPC in the hands of a public board of directors, responsible to an agency experienced in regulation of the securities markets." (Footnotes omitted) 421 U.S. at 422-23.

The authority vested in Federal Reserve Banks by Congress carries none of the requisite indicia of reviewability or actionability. This Court would have no statutory or

constitutional standard by which to judge the decisions that advances "should" or should not be made or that the Comptroller "should" have been "satisfied" as to insolvency sooner than he was. *Cf. Hadden* v. *Merritt,* 115 U.S. 25, 27-28 (1885); *Coleman* v. *Miller,* 307 U.S. 433, 453-56 (1939).* Sensitive judgment calls grounded on sophisticated economic expertise are not within the competence of the judiciary, as this Court has said. *Cf. Chicago & Southern Air Lines Inc.* v. *Waterman Steamship Corp.,* 333 U.S. 103, 111 (1948). The legislative history of the national banking acts evidences no congressional intention to vest in private persons a federal right to damages for a purported failure to act pursuant to the statute. *Cf. Securities Investor Protection Corp.* v. *Barbour, supra; Cort* v. *Ash,* 422 U.S. 66, 82-83 (1975) and *see, Inland Waterways Corp.* v. *Young,* 309 U.S. 517, 523-24 (1940).

The decision of a Federal Reserve Bank to advance funds against required collateral to a national bank suffering from a liquidity crisis is political in the same sense as a Congressional decision to lend Federal monies to a municipal or private corporation. One might argue—as a

* The authorities are unanimous that only the Comptroller may determine whether he is "satisfied" that a national bank is solvent, and that the courts cannot substitute their determinations for that of the Comptroller. *Easton* v. *Iowa,* 188 U.S. 220 (1903); *Casey* v. *Galli,* 94 U.S. 673 (1876); *Kennedy* v. *Gibson,* 75 U.S. (8 Wall.) 498 (1869); *United States Savings Bank* v. *Morgenthau,* 85 F.2d 811 (D.C. Cir)., *cert. denied,* 299 U.S. 605 (1936); *B.V. Emery & Co.* v. *Wilkinson,* 72 F.2d 10 (10th Cir. 1934); *Liberty Nat'l Bank* v. *McIntosh,* 16 F.2d 906 (4th Cir.) *cert. dism'd,* 273 U.S. 783 (1927); *Deweese* v. *Smith,* 106 F. 438 (8th Cir. 1901), *aff'd w/o opinion sub nom. Smith* v. *Brown,* 187 U.S. 637 (1902); *In re American City Bank & Trust Co.,* 402 F. Supp. 1229 (E.D. Wis. 1975); *United States Nat'l Bank* v. *Pole,* 2 F. Supp. 153 (D. Ore. 1932); *O'Connor* v. *Bankers Trust Co.,* 159 Misc. 920, 289 N.Y.S. 252 (Sup. Ct. N.Y. Co. 1936), *aff'd* 253 App. Div. 714, 1 N.Y.S.2d 641 (1st Dep't 1937), *aff'd,* 278 N.Y. 649, 16 N.E.2d 302 (1938); *cf. In re Conservatorship of Wellsville Nat'l Bank,* 407 F.2d 223 (3d Cir.), *cert. denied,* 396 U.S. 832 (1969).

political matter—over whether such loans were good or bad economic policy, but it would not be thought that they give rise to a claim by a private party that "fraud" or any other legally cognizable wrong had been committed.

Other courts have recognized that such policy considerations, in the precise context of the national banking scheme, preclude them from intruding on such delicate areas as are at issue here. In *Billings Utility Co.* v. *Advisory Committee,* 135 F. 2d 108 (8th Cir. 1943), a Federal Reserve Bank refused to make a loan under 12 U.S.C. § 352a, a section (later repealed) providing for working capital loans to businesses under "exceptional circumstances." The plaintiffs alleged that the refusal was "wilful, arbitrary, capricious," etc. and requested damages. The Court of Appeals for the Eighth Circuit affirmed a judgment for the Federal Reserve Bank, holding that its freedom to act upon any application for credit must be protected and such exercise of its discretionary authority is not reviewable. To the same effect, see *Raichle* v. *Federal Reserve Bank,* 34 F.2d 910 (2d Cir. 1929); *Bryan* v. *Federal Open Market Committee,* 235 F. Supp. 877 (D. Mont. 1964); and *Greene County National Farm Loan Ass'n* v. *Federal Land Bank,* 152 F.2d 215 (6th Cir. 1945).*

The comment by the court in *Fahey* v. *O'Melveny & Myers,* 200 F.2d 420, 472-73 (9th Cir. 1952) concerning the Federal Home Loan Bank System is pertinent:

> ". . . the 'determination' was a decision of a kind with which the judiciary should not be concerned, for courts have neither the aptitude nor the facilities to weigh the need for such orders which in our view belong in

* These decisions are but applications of the more general principle that, as stated by Chief Justice Marshall in *Marbury* v. *Madison,* 5 U.S. (1 Cranch) 137, 170 (1803): "Questions in their nature political, or which are, by the constitution and laws, submitted to the executive, can never be made in this court."

the domain of political power and are therefore not subject to judicial intrusion or inquiry. Decisions upon which such orders rested are delicate and complex, and necessarily involve large elements of prophecy and to that extent are akin to the decisions discussed in Chicago & Southern Air Lines, Inc. v. Waterman S.S. Corporation, 333 U.S. 103, ...

"We have to confront the fact that Congress created its own administrative agency to weigh all phases of the complex problems arising in the operation of the Home Loan Bank System and vested it with authority to use its discretion in ultimately determining in some formal manner the most suitable and desirable solution for specific problems one of which might be a readjustment of bank districts."

In sum, Huntington's dispute is not with the Reserve Bank, with the Comptroller, with the FDIC or, for that matter, with any "scheme" among them, but rather with the legislation governing national banks. Their recourse, if any, lies in the legislative and not the judicial process.

III.

There Is No Conflict Between Recognition of the Reserve Bank's Security Interest and the Policy of Ratable Distributions to Unsecured Creditors.

On October 8, 1974 the Reserve Bank released and agreed to release its lien upon collateral which might have included collateral pledged to Franklin National by Huntington. Huntington's argument in this regard therefore proceeds from the false premise that the Reserve Bank by virtue of its lien is a necessary party. The court below correctly held that the Reserve Bank is not.

But accepting *arguendo* the Huntington premise, once the Reserve Bank determined to exercise its discretionary authority to advance funds to Franklin National, it was required to obtain collateral satisfactory to it for such advances. Various statutes requiring that bodies clothed with a governmental purpose obtain security for their funds are the result of a strong national policy which is embodied in, but also predates the national banking acts. *Inland Waterways Corp.* v. *Young,* 309 U.S. 517 (1940). To void the lien of the Reserve Bank as an unlawful preference would both ignore the clear statutory mandate and as surely abrogate the Federal Reserve Banks' ability to make the advances as would a holding that the advances themselves were tortious.

The only federal statute under which the giving of a pledge or security for a loan to a national bank may be avoided is 12 U.S.C. § 91 (1970). *Schumacher* v. *Eastern Bank & Trust Co.,* 52 F.2d 925, 928 (4th Cir. 1931). The law is clear, and it has been for many years, that Section 91 can have no application to the situation presented here because the Reserve Bank received security interests only for "new money" it loaned Franklin National. 7 A. Michie, *Banks and Banking* § 239 at 458-59 (Cum. Supp. 1971). A preference, on the other hand, is created when a creditor receives security in respect of an antecedent debt in contemplation of a debtor's insolvency. *Armstrong* v. *Chemical National Bank,* 41 F. 234 (C.C.S.D.N.Y. 1890); *Lucas* v. *Federal Reserve Bank,* 59 F.2d 617 (4th Cir. 1932). To void security taken to secure a new loan would be to prefer the other antecedent creditors who would thus be benefitted by the loan while forcing the new lender to give up the security which induced him to extend the loan. *Stapylton* v. *Stockton,* 91 F. 326 (5th Cir. 1899).

Moreover, the prohibitions of Section 91 apply only when the collateral is received "after the commission of an act of insolvency or in contemplation thereof." The secured interest here did not come into being after "the commission of an act of insolvency." Nor can it be said that advances were made "in contemplation" of insolvency. Huntington itself asserts that "until it was declared insolvent, Franklin National continued to conduct business and deal with customers . . ." and Franklin National "continued to advance funds from time to time for the construction of [Huntington's] building until October 8, 1974. . . ." (Pet. p. 4). Because there was always the hope that the bank might survive and because it continued to conduct its business until the Comptroller's declaration, the Reserve Bank's assistance was not, as a matter of law, "in contemplation" of insolvency. *McDonald* v. *Chemical National Bank,* 174 U.S. 610, 618 (1899).*

This Court held in *Wyman* v. *Wallace,* 201 U.S. 230 (1906) that secured notes issued by a national bank which was unable to pay maturing deposits were valid, despite the argument that the predecessor of Section 91 precluded such a transaction.

> "The question, therefore, is, whether a national bank, finding itself embarrassed, with a large amount of

* In this respect, the giving of security for loans to a national bank is different from the securing of private deposits, which was the situation in *Roberts* v. *Hill,* 24 F. 571 (C.C.D.Vt. 1885) (Pet. p. 20) and *Texas & Pacific Ry.* v. *Pottorff,* 291 U.S. 245 (1934). In *Hirning* v. *Federal Reserve Bank,* 52 F.2d 382 (8th Cir. 1931) and *Vann* v. *Federal Reserve Bank,* 47 F.2d 786 (E.D.Va. 1929), also cited by Huntington (Pet. p. 20) a Federal Reserve Bank was merely acting as a collection agent after the drawee bank suspended operations; in neither case was security taken for new money, nor was the Federal Reserve Bank acting pursuant to statutory authority in its extraordinary capacity as a lender of last resort to member banks.

> assets, much in excess of its obligations, yet without the cash to make payment of those which are due and urgent, can borrow to meet those pressing demands. A very natural answer is, why not? It is not borrowing money to engage in a new business. It simply exchanges one creditor for others. There may be wisdom in consolidating all its debts into the hands of one person. At least such a consolidation cannot be pronounced beyond its powers. When time is obtained by the new indebtedness (in this case a year) it gives the borrowing bank and its officers and stockholders time to consider and determine the wisdom of attempting a further prosecution of business. In the case of an individual it would be a legitimate and often a wise transaction. It is not in terms prohibited by the national banking act." (201 U.S. at 243)

Other cases which recognize that it is entirely proper, and indeed desirable, for one bank to lend assistance to another bank in fianancial difficulties are *Harris* v. *Briggs,* 264 F. 726 (8th Cir. 1920); *Nakdimen* v. *First National Bank,* 177 Ark. 303, 6 S.W.2d 505 (1928); *Candor* v. *Mercer County State Bank,* 257 Ill. App. 192 (1930).

Huntington's real complaint is that a secured party may keep, or bargain away, his collateral in the event of default—as Congress intended when it required Federal Reserve Banks to make advances only against collateral. The right of a secured party has long been held not to conflict with the National Banking Act's requirement of ratable distribution to general creditors. *Ticonic National Bank* v. *Sprague,* 303 U.S. 406, 412 (1938). *Cf. American Surety Co.* v. *Bethlehem National Bank,* 314 U.S. 314, 317-19 (1941).

CONCLUSION

The petition presents no sufficient ground for review by this Court of the decision below. Rather, it presents an unsound argument to the Congress concerning the national banking legislation. The petition should be denied.

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